

Great Returns - for few

13 February 2006

Sunday Times



Warren Brown

South Africa's hedge fund industry continues to deliver good returns at low risk, though it is no closer to being regulated and hence not accessible to ordinary individuals.

Without regulation hedge funds will continue to deliver for high net worth individuals and a sliver of institutional money.

The winning hedge funds in this year's SYmmETRY Hedge Fund awards — the second year of the competition — provided "highly superior risk-adjusted returns", according to Warren Brown, the head of Alternative Investments at SYmmETRY.

Six local hedge funds received awards this week on a risk-adjusted basis.

In other words, in each category of hedge fund, the fund that provided the best return over one and two years to end-December 2005 — for the least risk — was the winner.

The best Overall Performance over one year went to Decillion Fairtree Fund with a return of 34%. While this was lower than the 47.3% achieved by the JSE's All Share index (Alsi) over the same period, the risk involved was significantly lower than the general market.

Last year's winner of this award, Breakwater Capital's Impact Fund, won the award for Best Overall Performance over two years with a return of 24.6% a year, compared with 35.9% from the Alsi.

Though the industry is talking to the Financial Services Board (FSB) about incorporating hedge funds into existing legislation, they are at this point unregulated, which means that there are no rules in place to protect investors in these funds.

However, SYmmETRY's Brown points out that regulation doesn't necessarily protect the investor.

Ian Hamilton, SA chairman of Aima (the Alternative Investment Management Association), said that the FSB was “very open to the process” and that Aima was, again, “hopeful that we’ll achieve something this year”.

“Worldwide, the norm for an individual to invest in hedge funds is \$1-million. The regulator has said that he doesn’t want to see retail products [for the man in the street] at this stage.”

However, funds of hedge funds could be very useful for retirement funds, he said.

According to the prudential guidelines that limit how one can invest retirement fund money, pension funds can invest a maximum of 2.5% of their assets in the “other” category, which includes hedge funds.

If hedge funds became regulated, retirement funds could allocate far more money to them.

Hamilton estimates that at the moment there is only R10-billion of retirement fund money in hedge funds. This amount could balloon if regulations were introduced.

- Other winners of SYmmETRY Hedge Fund awards were the fixed-interest strategy fund Coronation Granite Fixed Income, Blue Bay Mayflower Fund, which is a long-short equity fund, and Worldwide Capital Ploutos Capital, a trading fund.

- If there’s a sign that the stock market is looking peaky, it must surely be when the managers of hedge funds are encountering difficulty in finding stocks to “short”.

Going short is a way of making money out of shares that you think are likely to fall in value. It’s the opposite of “going long”, which is buying a stock and waiting for its price to go up.

When everyone is buying, it’s hard to find stocks that look like they’re going to fall.

Tracy Morkel, co-manager with Andrew Koch of Breakwater Capital’s Impact Fund, which won the award for best risk-adjusted performance over two years at this week’s awards, says: “It’s difficult to find shorts at the moment and there’s a lot of momentum in the market, which tells us that the market seems expensive.”

Though commentators have been calling the end to this bull market for some time, sooner or later they will be right – likely when bullish company earnings targets are finally missed.

The real attraction of hedge funds, however, is that they are not concerned with matching the performance of the stock market – they aim to control risk so that their investors do not receive negative returns when the markets crash.

This makes them ideal for the sophisticated investor who does not want to see his wealth erased by a market drawdown.

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